

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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GLADSTONE BUSINESS LOAN, LLC,	:		:
SUCCESSOR-IN-INTEREST TO	:		:
GLADSTONE CAPITAL CORPORATION	:		:
	:		:
Plaintiff,	:		:
	:	09 Civ. 4225 (LMM)	:
v.	:	<u>MEMORANDUM AND ORDER</u>	:
	:		:
RANDA CORP., ET AL.,	:		:
	:		:
Defendants.	:		:
- - - - -	-	X	:

McKENNA, D.J.

This action arises from Gladstone Business Loan, LLC ("Gladstone") seeking to recover sums allegedly due under a Capital Call Agreement between Randa Corp. ("Randa") and Gladstone. The Complaint alleges five claims: breach of contract, breach of the covenant of good faith and fair dealing, fraudulent-concealment, intentional misrepresentation, and civil conspiracy. Claim 1 alleging breach of contract is brought only against Randa. (Cmpl. ¶¶ 36-39.) The remaining claims are alleged against Randa, Jeffrey O. Spiegel ("Spiegel")<sup>1</sup> and Adnar Finance<sup>2</sup>, LLC ("Adnar"). Spiegel and Adnar seek to have the claims brought against them dismissed pursuant to Fed. R. Civ. P.

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<sup>1</sup> Jeffrey Spiegel it is alleged, "directly or indirectly owns and/or controls Randa, each of the Borrowers . . . and Adnar." (Cmpl. ¶ 17.)

<sup>2</sup> Adnar Finance is an entity established by Jeffrey Spiegel which purchased the senior loan which was taken out by Randa Luggage.

12(b) (6). This Court GRANTS the Defendants' motion to dismiss. Claims 2, 3, 4, and 5 are DISMISSED as to Spiegel and Adnar.

**I. Factual and Procedural Background:**

On a 12(b) (6) motion for dismissal a court will take factual allegations in the Complaint as true. "For purposes of reviewing the dismissal of a complaint for failure to state a claim, we accept the complaint's factual allegations . . . as true." Roth v. Jennings, 489 F.3d 499, 501 (2d Cir. 2007). Gladstone is a specialty finance company that invests in debt securities. On January 24, 2007, Gladstone and CapitalSource Finance LLC ("CapSource")<sup>3</sup> agreed to loan money to Randa Luggage, Inc. ("Randa Luggage").<sup>4</sup> Randa Luggage was engaged in the manufacture, distribution, and marketing of luggage, bags, backpacks and cases. Adnar Mem. at 3.

CapSource agreed to lend up to \$42,625,000 and Gladstone up to \$17,500,000 on a secured basis. (Cmpl. ¶¶ 11, 12.) CapSource held the senior position and entered into a subordination agreement with Gladstone. In April

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<sup>3</sup> CapitalSource Finance LLC like Gladstone provides commercial lending services. (Cmpl. ¶ 12.)

<sup>4</sup> The Complaint's claims against Randa Luggage are brought against the entities: Randa Luggage, Inc. and Randa Luggage Holdings Corp. This Memorandum and Order's reference to Randa Luggage encompasses both of these entities.

2008, Spiegel created an affiliate company called Adnar. (Cmpl. ¶ 8.) Adnar purchased the CapSource Loan on April 29, 2008. (Cmpl. ¶ 14.)

Galdstone objected to this transaction because the transaction would have the effect of subordinating Gladstone's loan below that of a loan owned by an entity controlled by Spiegel (who is alleged to control Randa Luggage). (Cmpl. ¶ 15.) Spiegel would control both the debtor (Randa Luggage) and the creditor (Adnar) - sitting on both sides of the transaction. Gladstone feared that the Defendants could use their position to "intentionally diminish the value of the Borrowers and render Gladstone's loan position worthless." Gladstone Mem. at 5.

On June 30, 2008 the parties attempted to resolve the dispute regarding Adnar's purchase of the CapSource Loan. Gladstone and Randa entered into a Capital Call Agreement ("Capital Call Agreement"). The Capital Call Agreement obligated Randa to pay \$1,250,000 (the, "Capital Call Amount") to Randa Luggage if there was a financial covenant default under the Gladstone Loan. If however, there was a monetary default under the Gladstone Loan then the Capital Call Amount must be paid in cash to Gladstone. (Cmpl. ¶¶ 18, 19.)

In December 2008, Randa Luggage breached the financial covenants of the Gladstone Loan and triggered a Capital Call Event. (Cmpl. ¶ 23.) In January 2009, the required principal and interest were not paid on the Gladstone Loan. The nonpayment triggered a monetary default under the Gladstone Loan. On January 27, 2009, Gladstone provided notice to Randa that a monetary default had been triggered and Randa was obligated to pay \$1,250,000 in cash to Gladstone.

On February 2, 2009, Randa replied that it did not have to pay the \$1,250,000 to Gladstone because it had converted "previously advanced loan proceeds that Adnar . . . was owed under the former CapitalSource Loan that it purchased." (Cmpl. ¶ 27.) Randa argued that forgiveness of a portion of the CapSource Loan which was owned by Adnar had the effect of fully satisfying Randa's obligations under the Capital Call Agreement. (Cmpl. ¶¶ 27, 28.) On February 19, 2009, Gladstone rejected Randa's assertion and argued that the conversion of a previously advanced loan amount did not constitute a 'cash payment' in accordance with the Capital Call Agreement. (Cmpl. ¶ 31.)

Further, Gladstone alleges that even if such contributions do qualify as 'cash payments' the contributions were never made by Adnar or Randa in November

or December of 2008. Records of the contributions are the result of fraudulent and intentional backdating of accounting records. "The Borrowers' financial records reflect that the Borrowers made a fraudulent accounting book entry purporting to convert \$1,250,000 from the Capital Source loan purchased by Adnar to common equity with a retroactive backdate of December 2008." Gladstone Mem. at 6 (citing Cmpl. ¶ 34.).<sup>5</sup>

On April 29, 2009, Gladstone filed suit in this Court against Randa Corp., Badanco Acquisition LLC, Randa Luggage Inc., Randa Luggage Holdings Corp., Jeffrey Spiegel and Adnar Finance. Shortly after the filing of the Complaint Randa Luggage Holdings Corp. and Randa Luggage Inc. (collectively, "Randa Luggage") filed for protection under Chapter 11, Title 11 of the United States Code in the United States Bankruptcy Court for the District of Delaware. Accordingly all claims against Randa Luggage were stayed. Adnar Mem. at 3.

On June 8, 2009, Spiegel and Adnar moved to dismiss Claims 2, 3, 4, and 5. Gladstone voluntarily agreed to dismiss Claim 2 alleging Spiegel and Adnar breached the

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<sup>5</sup> On a motion to dismiss this court must take all factual allegations in the Complaint as true. As such this court assumes that the backdating of accounting records occurred and no 'conversion of a loan' took place in November or December. Randa Luggage thus subsequently had a monetary default on the Gladstone Loan. This monetary default required Randa to pay \$1,250,000 'in cash' to Gladstone.

covenant of good faith and fair dealing. Gladstone Mem at 8.

## **II. Standard of Review**

To avoid dismissal of claims under Fed. R. Civ. P. 12(b)(6) Gladstone must plead "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a). However, adequate pleadings must raise a right to relief above the speculative level. "[A] plaintiff's obligation to provide the 'grounds' of his entitle[ment] to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 545 (2007).

The Second Circuit has held, "although 'a court must accept as true all of the allegations contained in a complaint,' that 'tenet' 'is inapplicable to legal conclusions' and '[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice.' . . . '[d]etermining whether a complaint states a plausible claim for relief will . . . be a context-specific task that requires the reviewing court to draw on its judicial experience and common sense.'" Harris v. Mills, --- F.3d ----, No. 07-CV-2283, 2009 WL 1956176

(2d Cir. July 9, 2009) (quoting Ashcroft v. Iqbal, 129 S.Ct. 1937, 1949–50 (2009)).

Claims alleged by Gladstone in the Complaint sound in fraud (fraudulent misrepresentation, fraudulent concealment and civil conspiracy). There is a heightened pleading requirement when a claim is grounded in fraud. Fed. R. Civ. P. 9(b) requires that fraud be pled with particularity. Harsco Corp. v. Segui, 91 F.3d 337, 347 (2d Cir. 1996). "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. We have explained that in order to comply with Rule 9(b), 'the complaint must: (1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent.'" Rombach v. Chang, 355 F.3d 164, 170 (2d Cir. 2004) (quoting Mills v. Polar Molecular Corp., 12 F.3d 1170, 1175 (2d Cir. 1993)). Under Rule 9(b), "[m]alice, intent, knowledge, and other condition of mind of a person may be averred generally." Fed. R. Civ. P. 9(b).

### **III. Discussion**

Spiegel and Adnar move for dismissal of Claims 2, 3, 4, and 5. Gladstone voluntarily agreed to dismiss Claim 2

against Spiegel and Adnar for breach of the covenant of good faith and fair dealing. Gladstone Mem. at 7-8. This Court will examine the surviving claims against Spiegel and Adnar.

**Claim 4 Alleging Intentional Fraudulent Misrepresentation Is Dismissed**

Gladstone alleges the Defendants made numerous false misrepresentations including that a prior Capital Call Event had occurred and Randa had satisfied its obligations under the Capital Call Agreement. (Complaint ¶ 54.)

"Under New York law, for a plaintiff to prevail on a claim of fraud, [one] must prove five elements by clear and convincing evidence: (1) a material misrepresentation or omission of fact, (2) made with knowledge of its falsity, (3) with an intent to defraud, and (4) reasonable reliance on the part of the plaintiff, (5) that causes damage to the plaintiff." Schlaifer Nance & Co. v. Estate of Andy Warhol, 119 F.3d 91, 98 (2d Cir. 1997) (citations omitted); Manning v. Utilities Mut. Ins. Co., Inc., 254 F.3d 387, 400 (2d Cir. 2001). Defendants argue that Gladstone does not identify the fraudulent misrepresentations, properly allege reliance, or plead damages. Adnar Mem. at 8.



The Complaint identifies the alleged misrepresentations with the particularity required by Fed. R. Civ. P. 9(b). The Defendants misrepresented that a 'capital contribution' had been made in December 2008 - when no 'capital contribution' was made at that time. (Cmpl. ¶ 22.) Further a letter from Randa signed by Jeffrey Siegel stated, "in November and December of 2008, Randa Corp. made cash equity contributions in aggregate amount of \$1,250,000 to the Borrowers." (Cmpl. Exhibit 5, Letter of Feb. 2, 2009 ("Feb 2, 2009 Letter").) Gladstone alleges the statement in the Feb. 2, 2009 Letter was false. The alleged misrepresentations are identified with the particularity required by Fed. R. Civ. P. 9(b).

However, the Complaint is deficient in alleging that Gladstone relied on any misrepresentations made by the Defendants. Under New York Law, a required element of fraud is that a party must show that it relied on a misrepresentation and that the reliance is reasonable. If the plaintiff "has the means of knowing, by the exercise of ordinary intelligence, the truth, or the real quality of the subject of the representation, he must make use of those means, or he will not be heard to complain that he was induced to enter into the transaction by misrepresentations." Schlaifer Nance & Co. v. Estate of

Andy Warhol, 119 F.3d 91, 98 (2d Cir. 1997) (quoting Mallis v. Bankers Trust Co., 615 F.2d 68, 80 (2d Cir. 1980)).

Gladstone states it "relied on Randa to comply with its obligations under the Capital Call Agreement and on the Borrowers to comply with its obligations under the Credit Agreement." (Cmpl. ¶ 58.) However, this does not establish that Gladstone relied on the misrepresentation. Gladstone must show that it relied on the alleged backdated bookkeeping entries to its detriment. The opposite appears to be the case. In a letter on February 19, 2009, attorneys for Gladstone reject the assertions that a 'capital contribution' was made. (Cmpl. Exhibit 6, Letter of February 19, 2009 ("Feb. 19, 2009 Letter").) "Suffice it to say, Gladstone categorically rejects the contentions raised in your letter. Randa's reliance on this alleged earlier equity contribution fails for a number of reasons . . . ." (Id.) The February 19, 2009 Letter goes on to provide four bases for Gladstone to reject the contention that Randa had fulfilled its obligations under the Capital Call Agreement.

A false statement does not create a tort for fraudulent misrepresentation if it is rejected and does not induce action. Schlaifer Nance & Co., 119 F.3d at 98. In this case the alleged misrepresentation (that the Capital

Call Amount had been paid) did not induce Gladstone to act to its detriment.

The claim for fraudulent misrepresentation is also deficient because it resulted in a breach of a term of the contract and not an independent harm. It is well settled that where a claim to recover damages for fraud, "is premised upon an alleged breach of contractual duties and the supporting allegations do not concern representations which are collateral or extraneous to the terms of the parties' agreement, a cause of action sounding in fraud does not lie." McKernin v. Fanny Farmer Candy Shops, Inc., 574 N.Y.S.2d 58, 59 (NY 2d. Dep't 1991). Further, "a contract action cannot be converted to one for fraud merely by alleging that the contracting party did not intend to meet its contractual obligations." Int'l Cabletel Inc. v. Le Groupe Videotron Ltee, 978 F.Supp. 483, 486-87 (S.D.N.Y. 1997) (quoting Rocanova v. Equitable Life Assurance Soc'y, 612 N.Y.S.2d 339 (N.Y. 1994) (quotations and additional citations omitted)).

Here the factual basis of the claim for fraudulent misrepresentation is a fraudulent misrepresentation which breached the terms of the contract. The misrepresentation does not occur outside of the contract terms or requirements nor does the misrepresentation breach a duty

which existed outside of the duty established by the contract. Manning v. Utilities Mutual Ins., Inc., 254 F.3d 387, 400 (2nd Cir. 2001). "Simply dressing up a breach of contract claim by further alleging that the promisor had no intention, at the time of the contract's making, to perform its obligations thereunder, is insufficient to state an independent tort claim." Telecom Intern. America, Ltd. v. AT & T Corp., 280 F.3d 175, 196 (2d Cir. 2001) (quoting Best Western Int'l v. Crown Sanitation Int'l Corp., No. 04-CV-0360, 1994 WL 465905, at \*4 (S.D.N.Y. August 23, 1994)). Claim 4 alleging fraudulent misrepresentation is dismissed on the independent bases that Gladstone has failed to establish reliance and the misrepresentation arose from the breach of a contract.<sup>6</sup>

### **Claim 3 Alleging Fraudulent Concealment Is Dismissed**

Gladstone alleges that the Defendants fraudulently modified the Borrowers' financial records to avoid Randa paying the Capital Call Amount. (Cmpl. ¶¶ 49, 50.)

Gladstone argues that the modification fraudulently

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<sup>6</sup> There is a limited exception under New York law when the existence of a contract itself is in doubt. In that case a party can bring a claim for breach of contract and a tort claim in the alternative. New York courts allow the Plaintiff to defer making an election as to contract or tort claims "where there is a dispute over the existence, scope, or enforceability of the putative contract." Reilly v. Natwest Markets Group, Inc., 181 F.3d 253, 263 (2d Cir. 1999). The existence of the Capital Call Agreement is not in dispute in this case and the exception described in Reilly is not available to Gladstone.

concealed Gladstone's breach of the Capital Call Agreement. Under New York law, in a cause of action for fraudulent concealment a plaintiff must plead the same five elements required for fraudulent misrepresentation, plus a duty on the part of defendant to make disclosure. City of New York v. Smokes-Spirits.com, Inc., 541 F.3d 425, 454 (2d Cir. 2008); see also Merrill Lynch & Co. v. Allegheny Energy, Inc., 500 F.3d 171, 181 (2d Cir. 2007).

The Complaint is deficient in pleading fraudulent concealment on the same bases as the misrepresentation claim. The Complaint fails to allege reliance on the alleged altered or concealed financial records. In addition, the concealment of the status of any payments to Randa Luggage (by altering financial records) is a breach of the Capital Call Agreement and not an independent tort. Accordingly, Gladstone's claim for fraudulent concealment as to Spiegel and Adnar is dismissed.

#### **Claim 5 Alleging Civil Conspiracy Is Dismissed**

Gladstone alleges that the Defendants conspired to defraud them by entering into an "agreement and/or understanding to manipulate the Borrowers' financial records to make it appear as if Randa made 'cash equity contributions.'" (Cmpl. ¶ 61.) Under New York Law, "[t]o

establish its claim of civil conspiracy, the [plaintiff] must demonstrate the primary tort, plus the following four elements: (1) an agreement between two or more parties; (2) an overt act in furtherance of the agreement; (3) the parties' intentional participation in the furtherance of a plan or purpose; and (4) resulting damage or injury."

Pasqualini v. MortgageIT, Inc., No. 05-CV-9714, 2009 WL 2407651, at \*15 (S.D.N.Y. August 05, 2009).

A conspiracy claim "'cannot stand alone' and must be dismissed if the underlying independent tort has not been adequately pleaded." Filler v. Hanvit Bank, 156 Fed. Appx. 413, 2005 WL 3270944 (2d Cir. 2005) (citing Romano v. Romano, 2 A.D.3d 430, 432, 767 N.Y.S.2d 841, 842 (2d Dep't 2003); see also Kirch v. Liberty Media Corp., 449 F.3d 388, 401 (2d Cir. 2006) (failure to state cause of action for torts underlying conspiracy allegations led to dismissal of claim for civil conspiracy). Allegations against Adnar and Spiegel of civil conspiracy are predicated on there being an actionable underlying tort (fraudulent misrepresentation or fraudulent concealment). This Court's dismissal of the above tort claims renders the civil conspiracy claim without an attendant tort. The claim of civil conspiracy to defraud is therefore dismissed.

IV. Conclusion

Defendants' motion to dismiss is GRANTED. Gladstone is GRANTED leave to replead within 30 days the dismissal of Claims 3, 4, and 5 as to Spiegel and Adnar.

SO ORDERED.

Dated: August 17, 2009

A handwritten signature in black ink, appearing to read "Lawrence M. McKenna", is written over a horizontal line.

Lawrence M. McKenna

U.S.D.J.